MONTHLY MARKET UPDATE

HD VEST FINANCIAL SERVICES®

May 2017

Economic data softened somewhat during May but remained expansionary. Survey measures of economic activity remained strong particularly for services. The Federal Reserve held rates steady at their May meeting. Equity markets were mostly positive while fixed income markets were positive for the month as expectations for global growth continue.

Key Economic Statistics*	Period	Level	Vs. Prior
Manufacturing Economy Strength	May	54.9	Stronger
Service Economy Strength	May	56.9	Weaker
Monthly Jobs Report	May	138k	Weaker
National Unemployment Rate	May	4.3%	Lower
Annualized Quarterly GDP Growth	Q1 – 2nd	1.2%	Higher
Personal Consumption (Spending)	Q1– 2nd	0.6%	Higher
Inflation–CPI ex.Food/Energy	April	1.9%	Lower

** See disclosure for underlying economic indicator definition. FactSet*

Subdued Volatility

Key Index Performance*	1 Mo	3 Mo	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Equities							
Large Domestic Companies S&P 500 Total Return Index	1.41	2.57	8.66	17.47	10.14	15.42	6.94
Small Domestic Companies Russell 2000 Total Return Index	-2.03	-0.83	1.48	20.36	8.00	14.04	6.40
International Developed Companies MSCI EAFE Index	3.67	9.23	14.01	16.44	1.53	10.21	1.06
Emerging Market Companies MSCI EM Index	2.96	7.87	17.25	27.41	1.62	4.54	2.28
Taxable Fixed Income							
Short Term Bonds Barclays U.S. 1-3 Year Aggregate Index	0.17	0.42	0.77	1.02	0.97	0.98	2.43
Intermediate Term Bonds Barclays U.S. Aggregate Bond Index	0.77	1.49	2.38	1.58	2.53	2.24	4.46
High Yield Bonds Barclays U.S. Corporate High Yield Index	0.87	1.81	4.79	13.58	4.73	7.31	7.46
International Government Bonds Citigroup World Government Bond Index	1.71	3.18	4.63	-0.46	-0.69	-0.16	3.44
Tax Exempt Fixed Income							
Short Term Municipals Barclays Municipal 1-3 Year Index	0.29	0.48	1.38	0.96	0.85	0.93	2.13
Intermediate Term Municipals Barclays Municipal 5-10 Year Intermediate Index	1.49	2.62	4.38	1.72	3.04	2.89	4.75
High Yield Municipals Barclays High Yield Municipal Index	1.53	2.45	6.36	4.60	5.06	5.42	4.46
Real Assets							
Commodities Bloomberg Commodity Index	-1.33	-5.40	-5.07	-2.45	-14.58	-8.24	-6.61
Global Real Estate Dow Jones Global Select REIT Index	0.25	-1.18	1.32	1.05	5.91	9.65	2.71

** All data as of 05/31/2017. See disclosures for underlying index definitions. Periods longer than one year represent annualized performance.*

Economic Update

Economic indicators still point to growth but some indicators are starting to soften compared to their recent readings. Both the service and manufacturing economy continue to expand. The service economy remained in robust expansionary territory with a 56.9 reading while manufacturing's growth had a slight uptick with a 54.9 print. Values above 55 are considered strong growth for the ISM indices. The Conference Board's Leading Indicator Index, which is combination of economic data series that tend to change direction ahead of shifts in the business cycle, continued to expand during April.

The first revision to the first quarter GDP report revised GDP growth up to a 1.2% rate from the first estimate's 0.7% growth rate. The upward revision was a result of larger increases in nonresidential fixed investment and personal consumption expenditures and smaller decreases in state and local government spending than had previously been estimated. Personal consumption expenditure (PCE) was revised up to a 0.6% growth rate from 0.4%. Despite being revised upward, PCE's deceleration from the fourth quarter's 3.5% growth rate combined with a downturn in private inventory investment were the primary drivers of deceleration in the first quarter's growth rate compared to the fourth quarter of 2016. [1]

May's Non-farm Payrolls report came in below expectations as the economy added 138,000 jobs. Consensus estimates were for May expected 180,000 jobs to be added. Previous month's additions were also revised downward. The unemployment rate declined further to 4.3% which is the lowest level since 2001. Hourly earnings continued to grow with a 0.2% monthly increase and 2.5% year over year increase. The average workweek held steady at 34.4 hours. The JOLTs report, which measures job openings in the economy, showed just over 6 million job openings and looks to have broken out of its recent trend of mid-5 to 6 million openings. Economists note that the Federal Reserve has a conundrum on its hands. Despite record openings and a low unemployment rate, wage gains and inflation are still below expectations which would weaken the argument for a further interest rate increases.[2]

The minutes from the May Federal Reserve meeting indicated that the Fed felt that the deceleration in growth in the first quarter was transitory and that they felt if economic information came in consistent with their expectations then "it would soon be appropriate for the committee to take another step" in raising rates. It appears that more dispersion in the view for the pace of rate hikes is developing as some officials noted that stronger hiring and wage gains could warrant a faster while some officials said that slower gains could warrant moving slower than projected. The minutes also indicate that a consensus of how to wind down the size of the Federal Reserve's balance sheet has been reached. Fed officials look to prefer an approach where they allow securities to mature and don't reinvest the proceeds. The Federal Reserve hasn't added to the size of its balance sheet in three years but has reinvested the proceeds of maturing securities to keep the size consistent. This has helped to hold down long term rates. The trimming of the balance sheet could push long term rates up.[3]

1 "Bureau of Economic Analysis National Income and Product Accounts Gross Domestic Product: First Quarter 2017 (Second Estimate)"

2 "Economists React to the May Jobs Report; 'Isn't a Disaster'" WSJ June 2, 2017

[3] "Fed Minutes Signal Officials Ready to Raise Rates Again Soon" WSJ May 24, 2017

Capital Markets Update

Equities were mostly positive in May while fixed income was positive. Domestic large caps, with the exception of large cap value, slightly declined through mid-May and then rallied to finish May in positive territory. Domestic small caps sold off during May and finished the month with a -2.03% return. International markets continued to outperform domestic markets as expectations for global growth have increased and doubts about significant policy changes for the US have emerged. Emerging markets performed in line with developed international markets for the month.

Earnings still seem to driving the recent rally. The earnings season for S&P 500 companies was strong as FactSet's year over year blended earnings growth rate, which includes estimates for companies that have yet to report combined with those that have reported, was 14% with 99% of the index reporting. This is the highest year over year growth rate since the third quarter of 2011. Revenue growth appears to be the dominant factor, as opposed to margin expansion, as the only sector expected to see a year over year decline in revenue is Telecom Services. Analysts are projecting earnings growth to continue through 2017.

This does not necessarily mean market expectations should follow as valuations are arguably rich at just over 20X trailing earnings. However, barring surprises the earnings dynamic may provide a floor to any shocks. Despite stronger recent performance, international and emerging valuations continue to look attractive relative to domestic securities.

It is worth noting that May had abnormally low volatility as measured by the VIX. The monthly average in May was 10.86 which was second lowest monthly average ever. The lowest was 10.82 in November of 2006. Outside of the average, the Vix closed below 10 four times during May which tied December of 1993 for the record number of closes below 10 in a month. Outside of those two months, the Vix has only closed below 10 five times.[4]

Within fixed income, markets were positive through May and over the last 3 months as interest rates declined slightly and credit spreads generally narrowed.

We have previously commented on the uneasy balance between lofty expectations and increasing uncertainty that those expectations will be met. May continued to do little to change that balance as the Trump administration seems determined to keep itself in a constant state of controversy. Despite the recent political controversies, Congress passed a dramatic roll back of the Dodd Frank Act that would soften oversight of financial institutions, significantly weaken the Consumer Protection Financial Board, repeal the Volcker rule, and repeal the Department of Labor's Fiduciary rule. While the bill has passed the House, its passage in the Senate is nearly impossible. That being said, it could serve as a framework for a relaxation of financial regulations that could pass both legislative bodies. This illustrates the need to remain diversified and not place a speculative bet on specific policy related outcomes.

We continue to believe a diversified portfolio of stocks and bonds is a reasonable approach to the uncertainty of the future market environment. However, as always, if recent market events have you concerned, we suggest contacting your HD Vest Advisory Representative.

Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses. Your individual allocation may be different than the HDVAS sample strategic model due to your unique individual circumstances.

4. “The VIX Snoozefest Kept Rolling in May” WSJ June 1, 2017

Disclosures:

Unless footnoted and disclosed otherwise, all economic data throughout report sourced from FactSet.

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Large domestic companies measured by the S&P 500, which is an index of 500 major U.S. large cap corporation.

Small domestic companies measured by the Russell 2000 Index which measures the performance of small-cap segment of the U.S. equity universe. Small domestic companies also measured by the S&P Small Cap 600 index.

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International developed companies measured by the MSCI EAFE Index, which is an unmanaged market capitalization-weighted index of equity securities of companies domiciled in various countries. The Index is designed to represent the performance of developed stock markets outside the United States and Canada and excludes certain market segments unavailable to U.S. based investors.

The Euro Stoxx index measures the performance of a subset of 12 Eurozone countries within the Stoxx Europe 600 index.

Emerging market companies measured by the MSCI Emerging Markets Index, which is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Short-term taxable bonds measured by the Barclays U.S. 1-3 Year Aggregate, which is a subset of the Barclays U.S. Aggregate index, representing securities with 1 to 3 years remaining until maturity.

Intermediate-term bonds measured by the Barclays U.S. Aggregate Bond index, which measures the performance of investment-grade bonds in the U.S. fixed-income universe. It includes U.S Treasury issues, agency issues, corporate bond issues and mortgage-backed issues. It is unmanaged, includes reinvestment of dividends, does not reflect the impact of transaction, manager or performance fees and is unavailable for investment.

High-yield bonds measured by the Barclays US Corporate High Yield Index, which tracks the performance of domestic non-investment grade corporate bonds.

International government bonds measured by the Citi World Government Bond Index (WGBI), which measures the performance of 23 government bonds markets including Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Malaysia, Mexico, the Netherlands, Norway, Poland, Portugal, Singapore, Spain, Switzerland, Sweden, the United Kingdom and the U.S.

Short-term municipals measured by the Barclays Municipal 1-3 Yr index, which measures the performance of investment-grade municipal securities with 1 to 3 years remaining until maturity.

Intermediate term municipals measured by the Barclays Municipal Intermediate 5-10 Year index, which measures the performance of investment grade municipal securities with 5 to 10 years remaining until maturity.

High-yield municipals measured by the Barclays High Yield Municipal index, which measures the performance of below investment-grade municipal securities with at least 1 year remaining until maturity.

Commodities measured by the Bloomberg Commodity index, which is comprised of future contracts on physical commodities which trade here in the U.S. and certain foreign markets. It measures the performance of investment in a broad basket of commodity futures contracts.

Real estate measured by the Dow Jones Global Select REIT index, which represents equity real estate investment trusts (REITs) and REIT like securities traded globally.

Manufacturing economy strength measured by the Institute for Supply Management Manufacturing Index. A measure above 50 indicates expansion while a measure below 50 indicates contraction.

Service economy strength measured by the Institute for Supply Management Non-Manufacturing Index. A measure above 50 indicates expansion while a measure below 50 indicates contraction.

Monthly jobs report measured by the Bureau of Labor Statistics' US Employees on Non-Farm Payrolls Month over Month net change.

National unemployment rate measured by Bureau of Labor Statistics.

Annualized Quarterly GDP Growth measured by Bureau of Economic Analysis and is released as preliminary (1st estimate), revised (2nd estimate) and final over the course of a quarter.

Personal Consumption growth measured by the Bureau of Economic Analysis and represents final market value of all goods and services produced in the U.S.

Annual Inflation Rate measured by the Bureau of Labor Statistics Consumer Price Index (CPI). Value reflects year over year change in the CPI ex-Food and Energy index.

An investment cannot be made directly into an index.

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